DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0435
Sales and Use Tax
For the Years 1998- 2000

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ISSUE

I. Sales and Use Tax-Imposition

Authority: IC 6-8.1-5-1, IC 6-2.5-3-2 (a), IC 6-2.5-5-3 (b), 45 IAC 2.2-5-8.

The taxpayer protests the imposition of use tax.

II. Tax Administration-Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b). 45 IAC 2.2-5-8 (c),

The taxpayer protests the imposition of the ten percent (10 %) negligence penalty.

STATEMENT OF FACTS

The taxpayer manufactures metal component sheets cut to customer specifications. The taxpayer slits, shears, levels, and cuts metal sheets for use in the manufacture of automobiles, appliances, computer housings, farm equipment, and a variety of other manufactured products. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax, interest, and penalty. The taxpayer protested the assessment of use tax on replacement parts for certain cranes and the penalty. A hearing was held on these issues. This Letter of Findings results.

I. Sales and Use Tax-Imposition

DISCUSSION

The taxpayer purchased parts to overhaul overhead cranes for bay 2 and bay 3 without paying sales tax at the point of purchase or self assessing use tax. The overhead cranes for bay 2 and 3 are used to move heavy metal coils from trucks into storage 30% and 40% of the time respectively. The cranes are used to remove the metal coils from storage to the first production machine 70% and 60% of the time for bays 2 and 3 respectively. The taxpayer protested the department's assessment of use tax on the percentage of the repair parts used for

moving the metal coils from storage to the spindle.

Indiana imposes an excise tax on tangible personal property stored, used or consumed in Indiana. IC 6-2.5-3-2 (a). There are several statutory exemptions from the use tax. All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. The taxpayer bears the burden of showing that any item meets the tests to qualify for exemption. . IC 6-8.1-5-1.

The taxpayer contends that the protested replacement parts for the overhead cranes in Bays 1 and 2 qualified for exemption from the use tax pursuant to the following provisions of IC 6-2.5-5-3 (b):

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

This exemption is clarified at 45 IAC 2.2-5-8 (c) as follows:

> The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

The exemption is explained as applying to repair and replacement parts of exempt machinery at 45 IAC 2.2-5-8(h)(2):

> Replacement parts, used to replace worn, broken, inoperative or missing parts or accessories on exempt machinery and equipment, are exempt from tax.

The regulation concerns the exemption of machinery if it is used in an integral and essential manner in the production process. To qualify for exemption, machinery must have an immediate effect on the production of the end product. It can only have an immediate effect if it touches and affects the raw material in such a way as to actually change it. Machinery is exempt only if it is used during the production process, not before the production process begins or after the production process ends. In the taxpayer's situation, the integrated production process begins at the first machine that has an immediate effect on the product. That first step in the integrated production process would be the spindle holding the coils for the slit-to-length or shearing machines. The movement of steel from storage to this point does not qualify for exemption.

The taxpayer contends that the taxability of the subject tangible personal property should be governed by the following example set out at 45 IAC 2.2-5-8(f)(12):

> A crane is used 40% of the time for the purpose described in Example (8), and 60% of the time to move raw materials from the stockpile to a production machine for processing. The taxpayer is entitled to an exemption equal to 60% of the gross retail income attributable to the transaction in which the crane was purchased.

The purpose referred to in the previous example is found at 45 IAC 2.2-5-8(f)(8) as follows:

> A truck is used on the federal highway and must be registered with the Indiana bureau of motor vehicles for highway use. The truck is used to transport a finished component part from the last step of a production process to be introduced into another integrated production process at another business location. The truck is taxable.

The taxpayer's example of exempt transportation does not apply in this situation. Example 12 refers to moving material from a stockpile in an integrated production process to a machine in that process rather than moving material to the beginning of an integrated production process as in example 8. The first step in the taxpayer's integrated production process is the spindle holding the steel for treatment by machines. The cranes at issue move raw material to that first step. Therefore, example 8 more closely resembles taxpayer's situation. The truck in example 8 is taxable. Likewise, the taxpayer's cranes and their repair parts are taxable.

FINDING

The taxpayer's protest is denied.

I. Tax Administration-Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to reach and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The taxpayer failed to pay sales tax or self assess use tax on several clearly taxable items such as office supplies, office telephones, office computers, logo golf balls, and warehouse supplies. In a previous audit, the taxpayer was also assessed additional use tax on office supplies. The

taxpayer's inattention to its duty to pay these taxes during this audit period constitutes negligence.

FINDING

The taxpayer's protest is denied.

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